



The Surety & Fidelity Association of America
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Making Sure the Job Gets Done: Surety Bonds and the Underwriting Process

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Fundamentals of Surety Bonding

- Proverbs 11:14-16
- 1894-Heard Act
- 1935-Miller Act
 - Current Law
 - \$150,000 Performance
 - \$30,000 Payment
- Little Miller Acts
 - State Law
 - Thresholds vary
- Prequalification
 - Capital (Credit)
 - Capacity (Capability)
 - Character (Reputation)
- Claim Services
 - Performance-protecting taxpayer dollars with a contract completion focus
 - Payment-protecting subcontractors/suppliers



Contractor Failure Rates

Building, heavy/highway, and specialty trade contractors

In Business	Survivors	Failure Rate
853,372 (2002)	610,357 (2004)	28.5%
850,029 (2004)	649,602 (2006)	23.6%
1,155,245 (2006)	919,848 (2008)	20.4%
897,602 (2009)	702,618 (2011)	21.7%
918,483 (2010)	696,441 (2012)	24.2%

Source: BizMiner



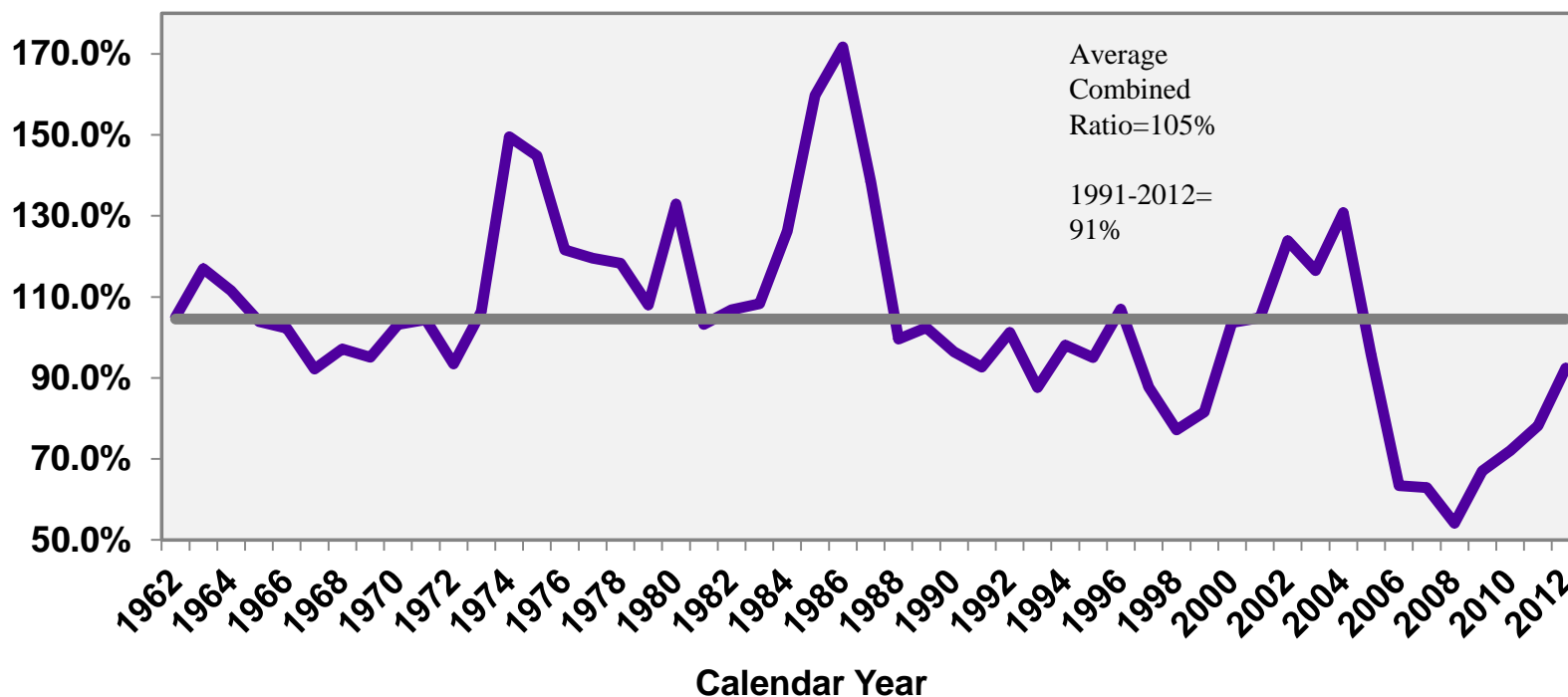
Large Established Contractors Fail Too

- Morrison Knudsen (1905-1995)
- Guy F. Atkinson (1926-1997)
- J.A. Jones (1890's-2003)
- Modern Continental (1967-2008)
- Ballenger (1937-2012)



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Contract Surety Industry Combined Ratios CY 1962 - 2012

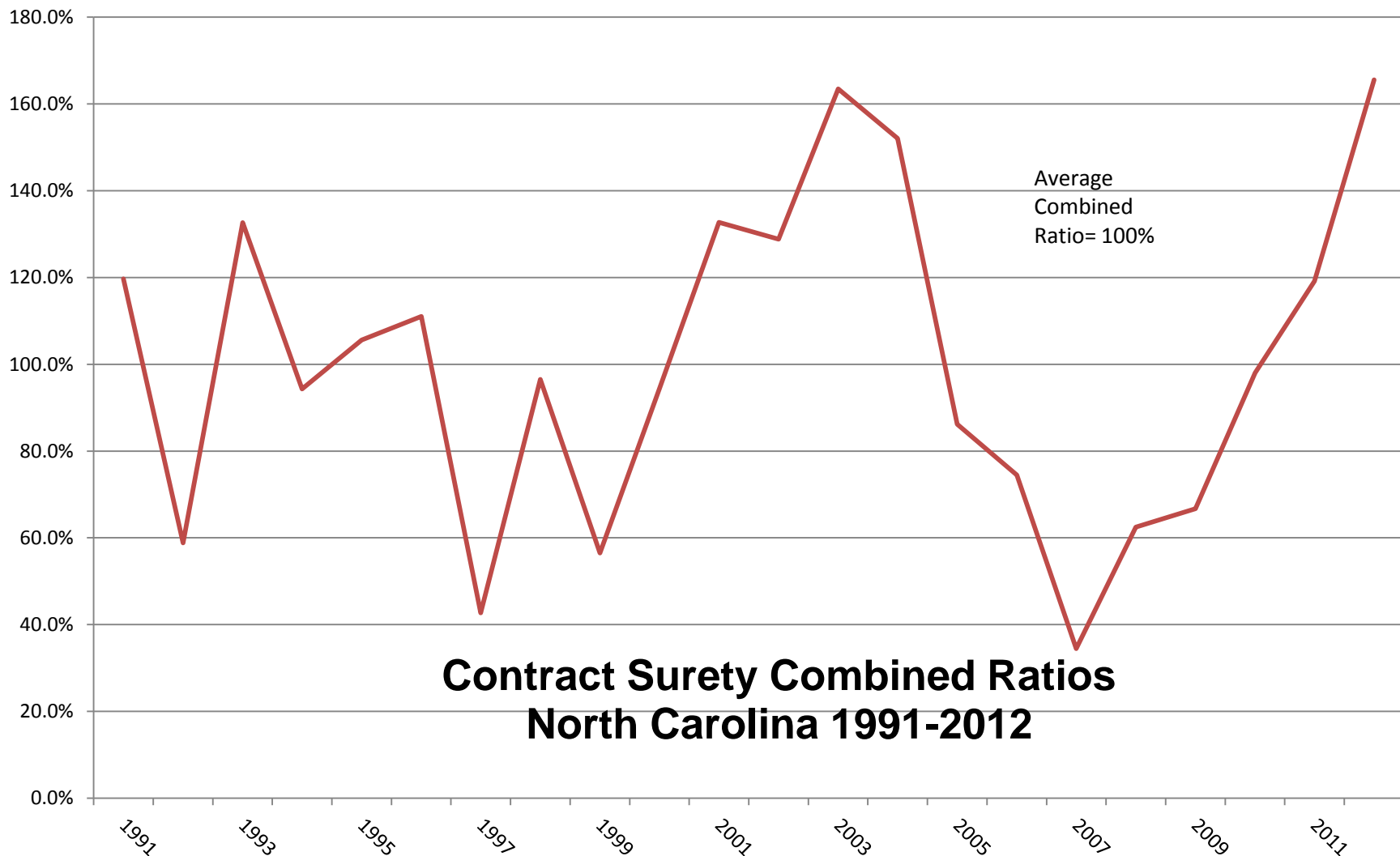


Surety and Fidelity Bonds: Protecting consumers, taxpayers, and businesses.



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General Underwriting Consideration

- Surety underwriting is a rigorous and thorough process
- A surety focuses on the entire work program of a contractor:
 - Bonded work
 - Unbonded work
 - Work in Process (WIP)
 - Specific project related contract review to determine if there are onerous provisions or prohibited work



General Underwriting Considerations

- Process of underwriting varies with size of the contractor and contract, sophistication of the contractor and procurement method (eg. Design, Bid Build, Design Build, P3, or CM @ Risk)
- Particular scrutiny is required when reviewing work that is outside the expertise of the contractor or specifically risky contract provisions (eg. excessive liquidated damages, consequential damages, long term warranties, efficiency guarantees and other onerous risk shifting provisions)



General Underwriting Consideration

- Indemnity-the cornerstone of the surety relationship
- Involvement with a surety bond producer who is licensed and understands the surety underwriting process
- Direct and regular contact with the contractor is required to obtain relevant and current information



How Sureties Underwrite

Areas of Assessment

The following list is not an exhaustive list of all the factors that a surety may consider. This presentation speaks in terms of basic practices that are found throughout the industry. Additional specifics can be provided for specific companies if requested.



Contractor's Background

- When was company started
- Type of work the company performs
- Prime/subcontractor mix
- Geographic market
- Prior surety history
- Duration of relationship
- Has surety met contractor and key personnel
- Who is the bonding agent for the account



Contractor's Financial Information

- CPA prepared financial statements
- Profitability
- Liquidity
- Debt
- Cash flow
- Credit rating



Contractor's Work Program

- Outstanding cost to complete
- How much of the bonding line is in use
- Bonded vs. unbonded mix
- Over/under billings
- Are projects successfully completed
- Are projects profitable



Contractor's Business Information

- Ownership and Structure
- Business Plan
- Key Management
- Continuity
- Related Entities
- References



If a surety agrees to support

- Normally, the surety will determine the surety line with two distinct limits, a single bond limit and an aggregate line and any terms and conditions (eg. more frequent reporting of financial information or even a collateral requirement)
- Once the surety provides a bond, the contract is financially supported by the balance sheet of an independent, licensed and regulated surety focused on project completion and payment of workers.



Cost of Prequalification

- The surety premium for the successful bidder pays for the prequalification cost
- That same premium also includes the claims handling process and services and the cost of both the performance and payment bond for the project
- Therefore, if the surety is wrong in its prequalification, its bond becomes the state's risk transfer mechanism for contract completion and payment of subcontractors and suppliers; supplementing any remaining contract balances



Risk Transfer

- A state entity determines the point of risk transfer when it sets its threshold in the Little Miller Act
- North Carolina has established the highest threshold in the country at \$500,000
- Statistical data shows that smaller contractors usually fail at greater rates and have higher losses when defaults occur
- The surety industry does not get an opportunity to support smaller, emerging and minority contractors
- Surety can be used as a tool to empower contractors, build sustainability, create jobs and build legacy wealth



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Thank you!!!

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